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As I See It

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RESIDENTIAL VALUES - 1948 - 1955

ON October 30, 1947, in an "As I See It" Bulletin, I charted residential values from 1938 to that time, with a guess based on information that was then available, extending the line to 1955. In that report I stated that this chart was given as a tentative estimate, with the promise that it would be revised from time to time as new developments took place which would indicate a change in the outlook. The chart on page 425 is our current revision. A comparison of it with the one of a year ago will show several changes.

1. No attempt was made in the earlier chart to show fluctuations in the value of the 50-foot lot on which the typical house was built, as the dollar effect on the completed property was relatively slight. This chart, however, attempts to show the fluctuations in the selling price of the lot from 1938 to the present, with an estimate of what the selling price might be from the present to 1955.

2. Due to many factors which could not be foreseen a year ago, building costs have continued to rise and have gone to a higher point than was anticipated then. At the present time the cost of building this house without the ground is 148 per cent higher than it was in 1939. (I still remember how shocked people in my audiences used to be when I said in the fall of 1939 that I thought the cost of building our house would double in the period ahead.)

3. The estimated cost of building this house in 1955 is higher on the current chart than it was on the chart of a year ago. Some of the cost factors going into the house, such as freight rates, have been solidified in such a fashion that they will offer considerable resistance to any downward movement.

It is unfortunately true that persons dealing with real estate must constantly make long-range guesses of the future. These guesses are always hazardous, as so many conditions may arise which are unpredictable and which cannot be foreseen that any guess, no matter how carefully it is made, may be wrong. During the later thirties I used to say that while we were very optimistic on the outlook for real estate, I thought there was about one chance in five that the first drunk questioned on Skid Row in any city might more accurately guess the future of real estate than it could be estimated from all measured trends available. As we have gone higher and higher in our real estate inflation, I have changed the odds in favor of the drunk. I now think that the probability of a better forecast on his part than could be derived from measured trends is one in three. The difficulty of prediction increases tremendously as the turning point is approached.

There is some slight revision in some of the figures for the past on our chart, particularly in the scarcity premium item during 1946 and 1947. We have made three surveys of the selling price of our standard six-room frame house in more than 150 cities, and the results of these surveys have been used in estimating the amount of scarcity premium each month.

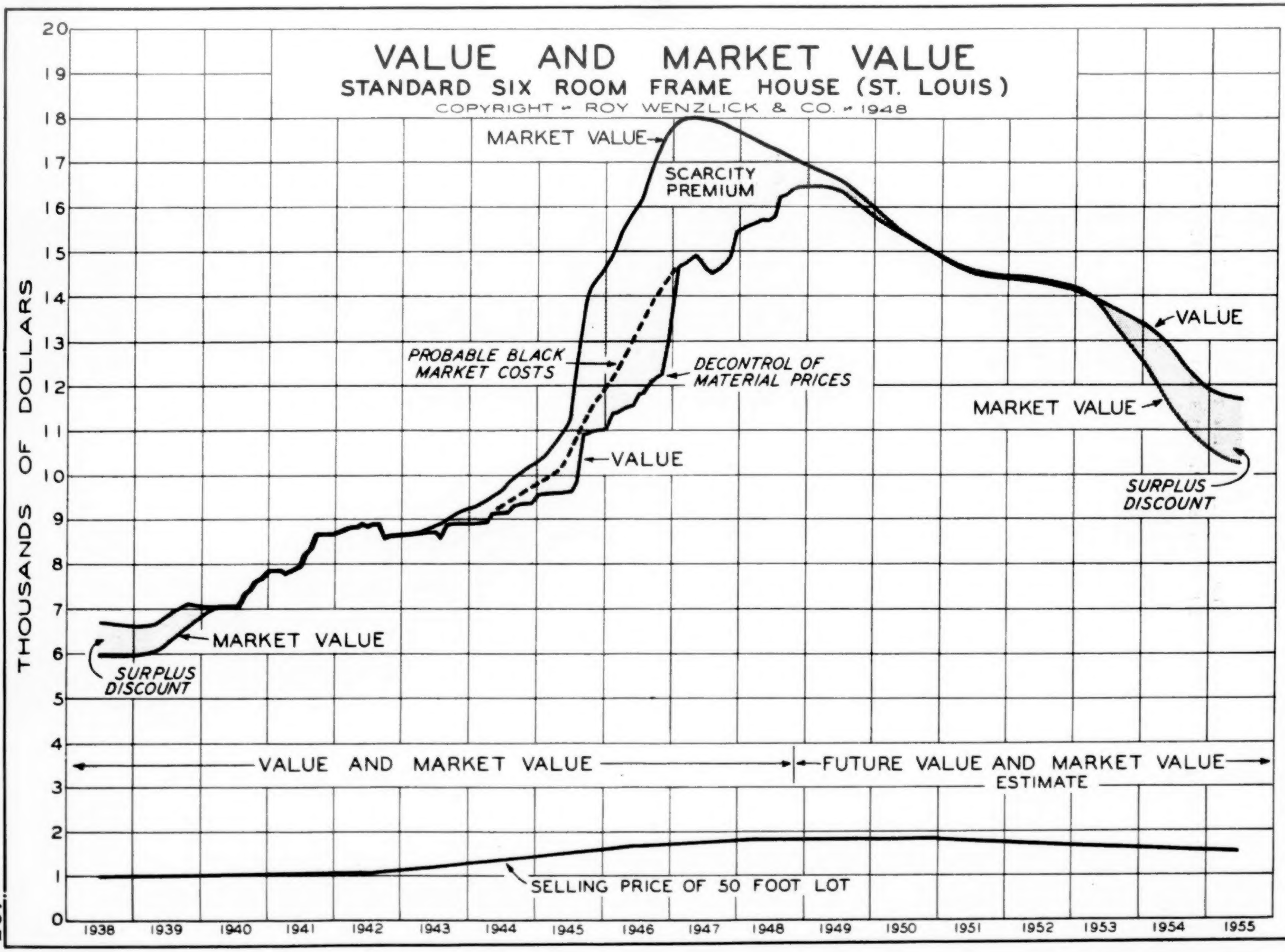
It will be noticed from the chart that we expect slightly further increases in construction costs, reaching a peak probably in the first part of 1949. We think there is some possibility of a slight decline in building costs during the second half of next year, with a continuation of the drop during 1950. We would not be at all surprised then to see a short period of stabilization, with a further drop in the middle fifties, hitting a low point probably around 1955 as shown on our chart, or even as late as 1957. The low point, during which a sizable surplus discount will exist, will be relatively short-lived, and the selling prices of houses will not stay on this distress level for a very long period.

The reasonableness of the drops in construction costs as shown on this chart for the future is important as, if these guesses are wrong, the guess on selling price will also be wrong, as replacement cost new determines to a large extent the selling prices of all existing useful buildings. The chart as we now have it shows construction costs of the building, exclusive of the land, in 1955 (which we are here assuming to be a bad depression year with distress labor and material costs) 73 per cent above the level of 1939. In other words, we are assuming that at the bottom of a very serious depression the cost of building a typical residential building will still be approximately three-fourths higher than it was in a fairly prosperous period when the war started in Europe. This is the effect of the war inflation, and this effect will be with us for a great many years in the future. The conservative

(cont. on page 426)

EXPLANATION OF THE CHART

THE chart on the page opposite shows the construction cost and market value of our standard six-room frame house in St. Louis from 1938 to the present, with an estimate of these factors to 1955. On the chart the solid black line at the bottom shows the selling price of a 50-foot lot suitable for the type building used in the study. The upper black line shows the replacement cost of the house and lot from the middle of 1938 to the present, with an estimate to 1955. The red lines on the chart show market value of a comparable existing building, below replacement cost in the first two years because of the surplus of properties on the market, above replacement cost for the period from 1943 to 1950 because of the scarcity existing, and below again in the period from 1953 on because of an over-supply for the economic conditions which will probably exist around that time. The broken dotted line on the chart shows the probable black market replacement cost of this building in contrast with the solid line, which shows the cost on the assumption that the building could be built at OPA prices (a condition contrary to fact). For the periods of the early forties and the early fifties the market is assumed to be in approximate balance, with neither scarcity premium nor surplus discount.


VALUE AND MARKET VALUE
STANDARD SIX ROOM FRAME HOUSE (ST. LOUIS)
COPYRIGHT - ROY WENZLICK & CO. - 1948
THOUSANDS OF DOLLARS
MARKET VALUE
SCARCITY PREMIUM
PROBABLE BLACK MARKET COSTS
DECONTROL OF MATERIAL PRICES
VALUE
MARKET VALUE
SURPLUS DISCOUNT
VALUE
MARKET VALUE
SURPLUS DISCOUNT
VALUE AND MARKET VALUE
FUTURE VALUE AND MARKET VALUE
ESTIMATE
SELLING PRICE OF 50 FOOT LOT
0
1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
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1955

(cont. from page 424)
nature of the drop we are estimating here can be seen by comparing it with the drop experienced in 1932 as a percentage of prewar. After construction costs doubled during the First World War they sank, until in 1932 at the bottom of the depression they were only 17 per cent higher than they were in 1914. The difference between 17 per cent and 73 per cent, the estimate in the second postwar depression period, is due to the more drastic nature of the inflation we have just been going through.

Another comparison which might be interesting would be a comparison of estimated construction costs in 1955 at the bottom of an assumed depression with the level they reached at the bottom of the last depression in 1932. If our estimate should prove to be right, we are assuming that another depression of the 1932 variety would still leave construction costs 129 per cent above their level in 1932.

A third comparison would be between the 1955 assumed depression level, and the peak construction cost in the last big building boom of the twenties. The 1955 assumed depression level is 37 per cent above construction costs on the inflated level of 1925.

In spite of very much higher levels we are expecting for the second postwar readjustment period, the change in selling price of existing buildings, particularly older buildings, may be very considerable. Our chart would indicate a possibility of a drop of 40 per cent in the selling price of some of these older buildings by the middle fifties. This takes into account that some scarcity premium still exists and that if a real depression develops, a large surplus discount will exist then, meaning that the surplus of properties on the market will force selling price for a while considerably below value.

The estimates of the future shown in this chart may be entirely too pessimistic, as we are told that no political party can allow a major depression to develop. It certainly is true that any administration will make every possible effort to prevent the spiraling of inflationary factors to the point where a major depression is inevitable. To me it seems, however, that the burden of proof still rests on those who think that a depression can be avoided. Of course, we can continue to inflate for some time longer, and so long as the inflation continues apparently all will go well. No inflation, however, can continue indefinitely, and every inflation which has attempted this has collapsed in a major depression. Great efforts were made to prevent the collapse in many cases by autocratic governments with absolute power. In a number of cases the policies designed to prevent the collapse carried a death penalty for lack of compliance. Even this could not change the basic truism that whatever goes up must come down.

ROY WENZLICK